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Common CAMELS Questions Answered

WASHINGTON, D.C. -- In response to questions from bankers and examiners about the December 1996 revisions to the Uniform Financial Institutions Rating System, commonly referred to as the CAMELS rating system, the Office of the Comptroller of the Currency (OCC) today issued two question and answer documents to its examiners and national banks.

The revised rating system, in effect since January 1, reflects major changes that include an increased emphasis on the quality of risk management practices and the addition of a new component on sensitivity to market risk -- the "S" in CAMELS. The other components are capital adequacy, asset quality, management, earnings, and liquidity.

The first Q-and-A document, developed jointly by the OCC, Federal Deposit Insurance Corporation, Office of Thrift Supervision, and Federal Reserve Board, primarily deals with the new market risk component and risk management issues. The second Q-and-A document, prepared by the OCC, deals with supervisory and examination issues faced by its examiners and some national banks. The purpose of both Q-and-A documents is to provide additional guidance and clarification for consistent and uniform implementation of the revised rating system.

The two Q-and-A documents make these major points:

Sensitivity to Market Risk Component

- The new "S" component rating reflects a combined assessment of a bank's level of market risk and the ability of the bank to manage that risk. Banks with low risk but inadequate market risk management may be subject to unfavorable ratings. Conversely, banks with moderate levels of market risk and a demonstrated ability to manage that risk are likely to receive favorable ratings.
- The sophistication of a bank's risk management system is expected to correspond with the complexity of its holdings and activities and be appropriate to its specific circumstances. Banks with relatively noncomplex holdings and activities, and with senior management actively involved in daily operations, may be able to rely on basic, less formal risk management systems.
- The composite CAMELS rating does not represent an arithmetic average of assigned component ratings. The weight attributed to any component in determining a bank's overall composite rating depends on the degree of supervisory concern associated with the particular component.
- Examiners will rely on existing supervisory guidance when

they review a bank's interest rate risk exposure, investments, financial derivatives activities, trading, and other activities to assess market risk exposures and risk management processes.

Risk Management Practices

- The increased emphasis by regulators on risk management practices and the addition of the new S component, by themselves, should not result in a change in the composite rating assigned to a bank. Market risk and risk management practices have traditionally been taken into account when evaluating a bank.
- Quantitative elements (levels of exposure, such as classified asset ratios) and qualitative elements (such as board and management oversight and risk management practices) are considered together in assigning component ratings. The relative importance given to either category depends on the circumstances particular to the bank being examined.

Composite and Component Ratings

- Peer data are used by examiners as part of the evaluation process and may be used in assigning a rating. However, peer data should not be relied upon in isolation to determine the rating.
- Examiners have the flexibility to consider any evaluation factor that, in their judgment, relates to component areas being reviewed.
- More than one reference to an evaluation factor across components is not considered "double counting". Each component is related to one or more other components. Examiners consider relevant factors and their relationship among components when assigning ratings.

Supervisory Processes

- The CAMELS rating system and the OCC's supervision by risk program exist in tandem. CAMELS remains a measurement of a bank's current overall financial, managerial, operational, and compliance performance. Supervision by risk prospectively assesses the quantity and direction of risks as well as the quality of risk management.

The revised rating system should not have a significant effect on noncomplex community bank examinations. For these banks, there is no need to obtain additional information or perform additional examination procedures to determine component and composite ratings.

The two Q-and-A documents also address issues such as changing ratings between examinations, rating discussions during exit meetings with senior management, and other examination issues.

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The OCC charters, regulates and supervises approximately 2,800 national banks and 66 federal branches and agencies of foreign banks in the U.S., accounting for more than half the nation's banking assets. Its mission is to ensure a safe, sound and competitive national banking system that supports the citizens, communities and economy of the United States.